Under the first option, there are many ways in which federal Medicaid matching rates could be reduced so that the average federal matching rate would fall by the desired amount. The impact on each state would depend on the exact formula used. Advocates believe that lowering matching rates would encourage states to operate their long-term care programs more efficiently, economizing on every dollar spent for long-term care. For example, states might replace costly institutional care with less expensive home- and community-based care for more beneficiaries. In addition, the open-ended feature of this option would enable those states experiencing growing needs for LTC--because of their growing elderly populations, for example--to respond with federal assistance, albeit at lower matching rates.

The second approach would limit each state's federal matching payment, while maintaining the current matching rates for spending up to the cap. (The Administration's proposal would apply such a limit to all Medicaid payments.) The cap would increase each year by the change in the medical care component of the Consumer Price Index. Advocates of this strategy prefer it to the first option because it would penalize only those states with the fastest growth in outlays. Also, it would make federal outlays more predictable than they would be under an open-ended matching arrangement.

Alternatively, a comprehensive block grant could be formed by combining federal payments for LTC into a single program that would replace LTC funding in the Social Services Block Grant, Title III of the Older Americans Act, and Medicaid. (LTC services provided by the Medicare program would not be affected by this approach.) Proponents say that comprehensive grants would significantly reduce the amount of fragmentation in the current system that often produces gaps and overlaps in services, and would lower administrative costs. Furthermore, such a plan would cause decisions to be made at the local level where, proponents argue, services could be tailored to local conditions and, therefore, provided more efficiently.

While all three strategies would reduce federal expenditures for long-term care, they would shift more responsibility to state and local governments. Also, the options would reduce the number of people receiving LTC unless states and localities were able to make up for losses in federal funds by greater efficiency or higher contributions. Critics suggest that capping federal Medicaid payments or forming a block grant would make the effective cost that states face of providing LTC so much higher over time that they would reduce services for the near poor. In addition, the same two options would penalize some states that have been best able to contain their LTC costs. Some critics also object to all three strategies because they separate funding for acute-care services from LTC funding. They believe such options would increase competition between the elderly and the non-elderly poor for scarce federal resources.

ENT-13 TAX EMPLOYER-PAID HEALTH INSURANCE

Addition to CBO Baseline	Annual Added Revenues (billions of dollars) 1988	1989	1990	1991	1992	Cumulative Five-Year Addition
Tax Some Employer-Paid Health Insurance						
Income Tax	2.0	3.7	4.5	5.5	6.5	22.2
Payroll Tax	1.2	2.0	2.4	3.0	3.5	12.1
Total	3.2	5.7	6.9	8.5	10.0	34.3
Tax Employer-Paid Health Insurance But Allow a Credit for Some Employer and Employee Contributions						
Income Tax	9.2	3.2	3.9	5.0	6.3	27.6
Payroll Tax a/	9.5	15.0	17.0	18.8	20.7	81.0
Total	18.7	18.2	20.9	23.8	27.0	108.6

a. The budget effects shown here for the payroll tax include the minor reductions in income tax revenues that would result from counting employer-paid health insurance as part of taxable wages under the payroll tax.

Employees do not pay taxes on income received in the form of employer-paid health care coverage. This exclusion will reduce 1989 income tax revenues and Social Security payroll tax revenues by a total of about $34 billion.

<u>Tax Some Employer-Paid Health Insurance</u>. One proposal to limit the exclusion would be to treat as taxable income any employer contributions (including those in cafeteria plans and flexible spending accounts) that exceed $200 a month for family coverage and $80 a month for individual coverage (in 1988 dollars), with these amounts indexed to reflect future increases in the general level of prices. This proposal would raise income tax revenues and payroll tax revenues by a total of $34.3 billion over the 1988-1992 period. Including employer-paid health care coverage in the Social Security wage base, however, would lead to increased outlays on benefit payments that would offset most of the added payroll tax revenues from this option over the long run.

Proponents of this approach point out that it would eliminate the tax incentive to purchase additional coverage beyond the ceiling. In the absence of such coverage, there would be stronger incentives to economize in the medical marketplace and reduced upward pressure on medical care prices. Over the long run, indexing the ceilings would limit their erosion by inflation. Finally, proponents note that the Congress has already limited the exclusion for employer-paid group life insurance (see REV-19).

Opponents object to limiting the tax subsidy, pointing to the difficulty of determining just when extensive coverage becomes excessive. They further argue that a uniform ceiling would have uneven effects, since a given employer's contribution purchases different levels of coverage depending on such factors as geographic location and the demographic characteristics of the firm's workforce. Finally, the indexing provision of this proposal would lead to declining subsidies for employer-paid health insurance over time, if health insurance costs continue to rise faster than the general level of prices. This effect is of concern to people who argue that these subsidies to private-sector benefits help avoid the need for public provision of the same benefits.

Tax Employer-Paid Health Insurance But Allow a Credit for Employer and Employee Contributions. Another option would be to treat all employer-paid health insurance premiums as taxable but offer a tax credit of 20 percent for health insurance premiums up to the amounts described above for family and individual coverage. The credits would be available to taxpayers regardless of whether the coverage was paid for or sponsored by an employer. At this credit percentage and with these premium ceilings, the proposal would increase income tax revenues and payroll tax revenues by a total of $108.6 billion over the 1988-1992 period. As under the first option, however, increases in Social Security outlays would offset most of the added payroll tax revenues in the long run.

Proponents of this approach argue that, in addition to eliminating the tax incentive to purchase health insurance above the limits, the subsidy would be made available to taxpayers without regard to their employment status. Moreover, the subsidy per dollar of eligible health insurance coverage purchased would not be higher for taxpayers with higher incomes. Others, however, object that this proposal does not go far enough, because the benefits of a tax credit would not be available to low-income individuals and families who have no liability under the federal personal income tax, unless the credit were made refundable. To do so would substantially reduce the net revenues discussed above, however.

As with the first option, some opponents argue that current health insurance coverage is not excessive. Others contend that the tax system should not be used to encourage purchases of certain goods or services and that extending the credit to those who currently have no employer-paid health insurance would do so.

ENT-14 RESTRICT COST-OF-LIVING ADJUSTMENTS IN NON-MEANS-TESTED BENEFIT PROGRAMS

Savings from CBO Baseline	Annual Savings (millions of dollars) 1988	1989	1990	1991	1992	Cumulative Five-Year Savings
	Eliminate COLAs for One Year					
Social Security/ Railroad Retirement	6,550	9,000	9,050	9,050	8,850	42,500
Other Non-Means-Tested Programs	1,700	2,300	2,400	2,450	2,550	11,450
Offsets in Means-Tested Programs and Medicare Premiums	-1,150	-1,900	-2,050	-2,200	-2,300	-9,600
Total	7,150	9,400	9,400	9,300	9,100	44,350
	Limit COLAs to Two-Thirds of CPI Increase for Five Years					
Social Security/ Railroad Retirement	2,250	5,400	9,000	12,600	16,250	45,450
Other Non-Means-Tested Programs	580	1,400	2,300	3,250	4,300	11,850
Offsets in Means-Tested Programs and Medicare Premiums	-70	-240	-430	-670	-910	-2,300
Total	2,750	6,600	10,850	15,200	19,600	55,000
	Limit COLAs to CPI Increase Minus Two Percentage Points for Five Years					
Social Security/ Railroad Retirement	3,200	7,750	12,500	17,500	22,650	63,550
Other Non-Means-Tested Programs	830	2,000	3,200	4,550	5,950	16,550
Offsets in Means-Tested Programs and Medicare Premiums	-100	-340	-610	-940	-1,250	-3,250
Total	3,950	9,350	15,100	21,100	27,300	76,850
	Pay Full COLA on Benefits Below a Certain Level and 50% of COLA on Amounts Exceeding That Level					
Social Security/ Railroad Retirement	710	1,750	2,900	4,050	5,250	14,650

Social Security and other non-means-tested cash transfer programs whose benefits are indexed to the Consumer Price Index (CPI) are expected to total $268 billion this year and to rise to $366 billion by 1992 under current policies. Reducing the automatic cost-of-living adjustment (COLA) for these programs is commonly proposed as an effective way to slow the growth in entitlement spending. Four strategies for reducing COLAs and the savings in outlays resulting from each are shown in the table. 1/ Other options for achieving savings in Social Security are given in ENT-15 and ENT-16.

Advocates of COLA restrictions view them as a means of generating considerable savings by spreading the burden over a large number of beneficiaries, in contrast to other budget options that would concentrate benefit reductions on smaller groups of recipients. By limiting these options to the non-means-tested cash benefit programs, many of the poorest beneficiaries of entitlements--for example, recipients of Supplemental Security Income--would be protected from losses of income. Significant reductions in outlays would persist beyond the five-year projection period because the benefit levels of those eligible when the COLA limitation was implemented would be permanently lowered. The savings would eventually disappear as beneficiaries died or ceased receiving payments for other reasons, unless the COLA limitation was accompanied by a permanent reduction in the initial benefits of newly eligible workers as well (see ENT-15).

Opponents counter that budget reduction strategies that institute less than complete price indexing would result in financial difficulties for many recipients, particularly if they were applied for an extended period. Although the exclusion of means-tested benefit programs would limit the impact of COLA reductions for many low-income beneficiaries, many others would face substantial declines in their standards of living. COLA reductions also encounter opposition from those who fear that changes made to reduce budget deficits would undermine the entire structure of retirement

1. The programs whose COLAs would be reduced under the first three options are: Social Security Old-Age, Survivors, and Disability Insurance (OASDI), Railroad Retirement, Civil Service Retirement, Military Retirement, Federal Employees Workers' Compensation, Veterans' Compensation, and retirement benefits for the Foreign Service, the Public Health Service, and the Coast Guard. The fourth option would affect only Social Security and Railroad Retirement Tier I COLAs. Curtailing COLAs could cause some beneficiaries' means-tested benefits to increase and could limit some scheduled premium increases for the Supplementary Medical Insurance part of Medicare, as shown in the table. Reductions in income tax revenues associated with COLA restrictions are not included.

income policy. Private pension plans generally do not offer complete indexing; COLA restrictions in Social Security would make it more difficult for beneficiaries to protect themselves against inflation. Opponents argue that these programs should be altered only gradually and then only for programmatic reasons, because Social Security and other retirement programs represent long-term commitments both to current retirees and to today's workers. Thus, any changes in benefits should be announced well in advance to allow people to adjust their long-run plans.

If COLA limitations were adopted to restrict the growth in benefits for people after they retire, commensurate changes could be made in determining initial benefits for new recipients to avoid introducing disparities in benefit levels among different groups of retirees. This situation is particularly relevant for Social Security, where benefits for those individuals becoming eligible are based on an indexed benefit formula and on indexed earnings histories. For example, if prices rose by 4 percent in a year and the wage index used to compute benefits for newly eligible recipients increased by 5 percent, eliminating that year's COLA without any change in the calculation of initial benefits would result in benefits for new beneficiaries that were about 5 percent higher than for recent retirees; under current law, benefits would be only about 1 percent higher for the new retirees. To mitigate this problem and to achieve additional savings, efforts to slow the growth in benefits through COLA limitations might be extended to the formulas determining initial benefits (see ENT-15).

Several options that would restrict COLAs for current beneficiaries are examined below. The magnitude of the savings in each case--except the option to limit COLAs to two percentage points less than the CPI--is very sensitive to the assumed level of inflation in the years in which the COLAs would be reduced.

Eliminate COLAs for One Year. One option would be to eliminate COLAs in fiscal year 1988 for non-means-tested benefit programs, while allowing them to be paid in subsequent years but with no provision for making up the lost adjustment. If this approach were taken, federal outlays would be reduced by about $7.1 billion in 1988 and $44.3 billion over five years, with Social Security and Railroad Retirement accounting for most of the total. These estimated reductions would be larger or smaller if prices were to rise faster or slower than the 4.1 percent increase currently assumed for the fiscal year 1988 COLA.

Limit COLAs to Two-Thirds of CPI Increase. Under this option, recipients would be compensated for only a certain proportion of inflation, such as two-thirds of the annual CPI increase. Under current CBO economic assumptions, applying this restriction for five years would save about $2.8 billion next year and $55 billion over the 1988-1992 period. As a result, benefits for people who received payments throughout the five-year period would be about 7 percent less in 1992 than they would have been under full price indexing. Both cumulative savings and reductions in real income would be greater in an environment of higher inflation and smaller under low inflation.

Index Benefits by the CPI Increase Minus Two Percentage Points. An approach similar to the proportionate COLA reduction would be to reduce the adjustment by a fixed number of percentage points--for example, set the adjustment at the CPI increase less two points. In this case, both savings and effects on beneficiaries would be roughly the same regardless of the level of inflation--about $76.8 billion over the next five years, if extended for the full period. This option would reduce real incomes by about the same percentage every year, regardless of the inflation rate, whereas the two-thirds-of-COLA approach would reduce the purchasing power of benefits most sharply when inflation is high during the five-year period.

Pay the Full COLA on the Portion of Benefits Below a Certain Level and 50 Percent of the COLA on Benefits Exceeding That Level. To ensure that lower-income beneficiaries would not be adversely affected by COLA reductions, some analysts have suggested tying the reduction to beneficiaries' incomes or payment levels. The example discussed here--based only on Social Security and Railroad Retirement Tier I benefits--would award the full COLA for benefits based on the first $400 of a retiree's Primary Insurance Amount (PIA) and 50 percent of the COLA on benefits above this level; the $400 threshold would also be indexed by the full COLA. This approach would save about $0.7 billion in 1988 and $14.7 billion over the 1988-1992 period. (Another option would be to eliminate COLAs to recipients whose benefits are based on PIAs above a certain level. This COLA reduction would affect the entire benefit of each recipient above the threshold, not just the portion above that level.)

Several concerns are raised regarding this approach. First, benefit levels are not always good indicators of total income. Some families with high benefits have very little other income, while some with low benefits have substantial income from other sources. On the other hand, targeting the COLA restraint on the basis of total income would be administratively complex. Indeed, implementation of the PIA-based option itself would involve considerable effort and would require a longer lead-time than the other COLA options because the Social Security Administration would need to rewrite many computer programs. (The budgetary savings estimates shown above nonetheless are based on implementation in time for the January 1988 COLA.) Second, if this proposal were extended to include other benefit programs, the different benefit structure in each program might require separate determinations of the appropriate benefit levels for paying the reduced COLA. Third, many people object to any changes in retirement programs that might be construed as introducing a means test for benefits, even if the "test" is limited only to the COLA.

ENT-15 REDUCE THE REPLACEMENT RATE WITHIN EACH BRACKET OF THE SOCIAL SECURITY BENEFIT FORMULA

Savings from CBO Baseline	Annual Savings (millions of dollars) 1988	1989	1990	1991	1992	Cumulative Five-Year Savings
Outlays	80	280	530	850	1,250	3,000

Under current law, the basic Social Security benefit is determined by a progressive formula that provides workers with 90 percent of their Average Indexed Monthly Earnings (AIME) up to the first bend point (which defines the first earnings bracket), plus 32 percent of the AIME in the second bracket, plus 15 percent of the AIME above the second bend point. One method of reducing initial Social Security benefits would be to lower the three replacement rates by a uniform percentage. For example, lowering the three rates in the benefit formula from 90, 32, and 15 to 86.5, 30.8, and 14.4, respectively, would achieve an essentially uniform 3.9 percent reduction in the benefits of newly eligible workers--the same as the reduction in benefits that currently eligible workers would incur by forgoing the projected January 1988 COLA. The reduction in the replacement rates would save about $3.0 billion from Social Security outlays over the 1988-1992 period and more in later years.

Under this option, replacement rates for all newly eligible workers would be about 3.9 percent lower starting in 1988 than they would be under current law. Thus, a 62-year-old retiree who has always earned the average wage would receive initial benefits in 1988 of about 33 percent of pre-retirement earnings, compared with 34 percent if no change is made. This option could be coordinated with a cost-of-living adjustment option (see ENT-14) to ensure that benefits for both current and future beneficiaries would be reduced to a similar extent.

Opponents of cuts in initial benefits contend that it is not necessary to make any permanent reductions beyond those made by the Social Security Amendments of 1983, because the combined assets of the retirement and disability trust funds are expected to be sufficient to pay benefits for at least the next half century. One of the changes made by the 1983 amendments was to increase from 65 to 67 the age at which unreduced Social Security retirement benefits are first available. The change is to be phased in between the years 2000 and 2022. As a consequence, initial benefits for most workers retiring after the turn of the century are likely to decrease anyway, relative to what they would have received had the full retirement age not been increased. For example, a worker who retires at age 62 in 2022 will receive 70 percent of the Primary Insurance Amount rather than 80 percent.

On the other hand, long-term projections of outlays and revenues should be treated with caution because they are enormously sensitive to the assumptions on which they are based. Reductions in initial benefits or other changes in Social Security benefits or taxes could be enacted as a precautionary measure.

ENT-16 ELIMINATE SOCIAL SECURITY BENEFITS FOR CHILDREN OF RETIREES AGED 62-64

Savings from CBO Baseline	Annual Savings (millions of dollars) 1988	1989	1990	1991	1992	Cumulative Five-Year Savings
Outlays	40	180	360	590	650	1,820

Under current law, unmarried children of retired workers are eligible for Social Security dependents' benefits as long as they are under age 18, or attend elementary or secondary schools and are under age 19, or become disabled before age 22. These benefits help families with children maintain an adequate standard of living after the worker's retirement. A child's benefit is equal to one-half of the parent's basic benefit, subject to a dollar limit on the maximum amount receivable by any one family. If such benefits were eliminated for the children of retirees aged 62 through 64, beginning with retirees reaching age 62 in October 1987, the savings would total about $1.8 billion over the next five years.

This option might encourage some retirees to stay in the labor force longer. At present, though benefits for retired workers and their spouses are actuarially reduced if retirement occurs before age 65, children's benefits are not. Further, the younger the workers are, the more likely they are to have children under age 18. Thus, workers under age 65 now have an incentive to retire while their children are still eligible for benefits. This incentive would be quite small, however, for families in which spouses are also entitled to dependents' benefits, since the maximum family benefit limits the increase in total benefits attributable to eligible children for these households.

On the other hand, for families with workers whose retirement was not voluntary--because of poor health or unemployment, for example--the loss in family income might cause some hardship. Moreover, since spouses under age 62 receive benefits only if their children under age 16 also receive benefits, eliminating children's benefits for families of early retirees would also result in the loss of spouses' entire benefits in some families. In such cases, the total loss of income could be significant.

ENT-17 ELIMINATE CERTAIN VETERANS' COMPENSATION PAYMENTS FOR THOSE WITH LOW-RATED DISABILITIES OR END ALLOWANCES FOR DEPENDENTS

Savings from CBO Baseline	Annual Savings (millions of dollars) 1988	1989	1990	1991	1992	Cumulative Five-Year Savings
Eliminate Compensation for Low-Rated Disabilities						
Budget Authority	1,300	1,350	1,450	1,450	1,550	7,100
Outlays	1,200	1,350	1,400	1,400	1,550	7,000
End Certain Dependents' Allowances						
Budget Authority	210	220	230	240	240	1,130
Outlays	190	220	230	230	240	1,110

Veterans' disability compensation provides cash benefits to about 2.2 million veterans with service-connected disabilities. Compensation is based on a rating of their impairments and an average reduction in ability to earn wages in civilian occupations. The disability ratings represent 10 percent differences in functional limitations or severity of the impairment, whereby some veterans may also be categorized as "unemployable" if their rating is 60 percent or higher. Additional allowances are paid to veterans with disabilities rated 30 percent or greater and who have dependent spouses, children, or parents.

Eliminating cash benefits for those with disability ratings below 30 percent would reduce federal outlays by about $7.0 billion between 1988 and 1992. About 1.2 million veterans would lose all their cash benefits (currently between $69 and $128 per month), but they would retain their eligibility for medical care and other associated benefits. Alternatively, ending only the dependents' allowances for those with ratings below 60 percent would save $1.1 billion between 1988 and 1992. For about 410,000 veterans whose disability ratings are 30 percent, 40 percent, or 50 percent and who have dependents, benefits would be reduced by an average of about $40 per month.

Advocates believe each option would target benefits toward the most impaired and perhaps the medically neediest of the disabled veterans and their families. The first option would bring compensation for disabled veterans more in line with workers' compensation programs, which generally provide only temporary cash or medical benefits for low-rated impairments. It would also link the compensation more closely with performance on civilian jobs that depend less on physical labor than when the associated cash payments were originally set. Because of the availability of and improvements in reconstructive and rehabilitative medicine, proponents question whether veterans with impairments rated below 30 percent suffer any reductions in their earnings as a result of their low-rated disabilities. Many of these veterans are compensated for physical impairments such as mild arthritis, moderately flat feet, or one partially amputated finger, which may not affect their ability to work.

Similarly, proponents of the second option argue that the rising participation of women in the labor force means that dependents' allowances for veterans with disability ratings of 30 percent to 50 percent are often not necessary to maintain adequate family incomes. Moreover, they contend that veterans with ratings below 60 percent are likely to be fully employed and able to provide for their families.

Opponents, however, view these benefits as indemnity payments owed to veterans disabled to any degree while serving in the armed forces. Furthermore, older beneficiaries who have retired from work may rely heavily on their compensation income, so that even a small reduction in payments could have a greater impact on them than on younger veterans. Other disabled veterans might find it difficult to increase their working hours or otherwise manage to make up the loss in payments.

An alternative option would be to reduce or eliminate benefits to veterans with low-rated disabilities who have already received their benefits for more than a certain number of years. For example, eliminating compensation for those veterans with disabilities rated below 30 percent after the initial two years of payments would result in only slightly smaller savings over the next five years. At the same time, it could provide benefits to these veterans when some might most need them.

ENT-18 REQUIRE A TWO-WEEK WAITING PERIOD FOR UNEMPLOYMENT INSURANCE BENEFITS

Savings from CBO Baseline	Annual Savings (millions of dollars)					Cumulative Five-Year Savings
	1988	1989	1990	1991	1992	
Budget Authority	--	--	--	--	--	--
Outlays	--	1,200	1,300	1,450	1,500	5,450

NOTE: These estimates assume that the change is not implemented until fiscal year 1989, to allow time for changes in state Unemployment Insurance laws.

Current federal law imposes no mandatory waiting period before jobless workers can receive Unemployment Insurance (UI) benefit payments, although the Omnibus Reconciliation Act of 1980 does require states to adopt a one-week waiting period on regular UI benefit payments or lose some federal benefits under the extended UI program. About three-quarters of the states now require a one-week waiting period for regular UI benefits.

If all jobless workers were required to wait two weeks before receiving UI benefits, program outlays would be reduced and beneficiaries in all states would be treated uniformly. Such a change would not affect the maximum length of time during which workers could collect benefits; for example, a person otherwise eligible for 26 weeks of benefits would retain that eligibility but would receive payments during weeks 3 through 28 of joblessness. Benefits would be reduced, however, for those recipients not using the maximum number of covered weeks. If implemented in 1989 (to allow time for states to change their UI laws), this option would cut UI outlays by nearly 8 percent, or by about $5.5 billion between then and 1992.

This option could significantly reduce the incentive of workers to become unemployed and collect UI benefits by increasing the initial cost of joblessness, yet it would not greatly affect the program's ability to help the long-term unemployed. Restricting aid in this way might lower the number of workers who apply for assistance and reduce the duration of benefits paid to many who do apply.

On the other hand, because this change would reduce the benefits provided to jobless workers who do not use all of their entitlement, it would diminish the income support role of UI. In addition, opponents maintain that covered workers are entitled to benefits when they become unemployed, and that this change would erode the insurance protection of UI. Finally, some people oppose this change because it would impose additional federal restrictions on state UI programs, even though it is state UI taxes that finance regular UI benefits.

ENT-19 INDEX THE UNEMPLOYMENT INSURANCE TAXABLE WAGE BASE

	Annual Added Revenues (billions of dollars)					Cumulative Five-Year Addition
	1988	1989	1990	1991	1992	
Addition to CBO Baseline	--	0.2	0.6	0.7	0.6	2.1

NOTE: These estimates assume that the change is implemented in January 1989, to allow time for changes in state laws. Further, some states with Unemployment Insurance programs in good financial condition are assumed to offset at least part of the increases in the state tax base with reductions in state tax rates.

The joint federal/state Unemployment Insurance (UI) program is financed primarily through federal and state payroll taxes on employers. The federal UI taxable wage base--which also serves as the minimum base for state UI taxes--is currently $7,000 per worker and has been increased only three times from its level of $3,000 in 1940. The proportion of total wages subject to the federal tax has thus fallen from over 90 percent in 1940 to less than 40 percent now. In contrast, UI benefits tend to increase with nominal wages, because benefits are based in part on prior earnings and because many states index their maximum weekly benefit to average weekly wages. Indexing the federal UI wage base by linking it to national average earnings--as is done with the Social Security base--would increase combined federal and state UI revenues by about 3 percent, while reducing the federal budget deficit by about $2.1 billion over the 1989-1992 period. This estimate of the budgetary effect includes the reduction in income tax revenues that would result from the UI tax increase.

This option could help stabilize the long-term financial position of the UI system by allowing revenue increases to follow a path similar to benefit gains. Revenue from the federal UI tax would increase nearly in proportion to the rise in the base. State UI tax receipts also would increase, although probably less than proportionately because many states whose UI programs are in good financial shape would be likely to reduce their tax rates. Overall, state tax rates have risen from an average of 1.3 percent of taxable wages in 1970 to about 2.7 percent in 1986. Finally, by concentrating the tax increase on the wages of workers now earning more than the current tax base, this change would make the UI tax somewhat less regressive than it is now.

Because this change could result in higher labor costs for employers, however, it might adversely affect employment levels. In addition, mandating increases in minimum wage bases for state UI taxes would limit somewhat the flexibility of states in designing tax systems to finance their UI benefits. Although states in good financial condition could offset the total amount of this change by lowering tax rates, there would be some redistribution of tax payments by different firms.

ENT-20 MAINTAIN THE CURRENT FEDERAL UNEMPLOYMENT INSURANCE TAX RATE

	Annual Added Revenues (billions of dollars)					Cumulative Five-Year Addition
	1988	1989	1990	1991	1992	
Addition to CBO Baseline	0.7	0.8	0.8	0.5	0.3	3.1

Under current law, the minimum net federal Unemployment Insurance (UI) tax rate is 0.8 percent for the first $7,000 paid annually to workers. One-quarter of this tax rate--or 0.2 percent--is a temporary amount added to repay certain outstanding loans from the general fund of the U.S. Treasury to the Unemployment Trust Fund. These loans are expected to be repaid during 1987, so that under current law the rate would be reduced to 0.6 percent beginning in January 1988. Maintaining the present rate of 0.8 percent would increase combined federal and state UI revenues by about 4 percent, while reducing the federal budget deficit by about $3.1 billion over the 1988-1992 period. This estimate of the budgetary effect includes the reduction in income tax revenues that would result from maintaining the higher UI tax rate.

Under this option, balances in the federal UI accounts in the Unemployment Trust Fund are projected to reach their statutory maximums beginning in 1988. The excess funds would be transferred to the states' UI accounts, probably leading some of them to lower their UI tax collections. Such an offsetting reduction is also reflected in the budgetary estimates.

Some proponents argue that the additional UI revenues collected under this option could be used to finance extended benefits in the next recession. Others contend that some of the funds could be used to train unemployed workers, thereby potentially reducing the long-term costs of UI, although in this case the near-term deficit would be reduced by less. In addition, supporters point out that this option would increase program revenues without imposing additional restrictions on the states' UI programs.

Opponents contend, however, that once the UI loans from the Treasury are repaid the need for this added revenue will be eliminated and the tax rate should be lowered as planned. Further, because this option would not allow labor costs for employers to fall, it would lead to somewhat less overall employment than under current law.

ENT-21 REDUCE AND RETARGET AID FOR DEPENDENT CARE

Savings from CBO Baseline	Annual Savings (millions of dollars) 1988	1989	1990	1991	1992	Cumulative Five-Year Savings
Gross Revenue Gain	270	1,800	2,000	2,150	2,350	8,550
Outlays a/	135	900	1,000	1,075	1,175	4,275
Net Savings	135	900	1,000	1,075	1,175	4,275

a. Negative numbers reflect increased outlays for the SSBG (see text) and assume 100 percent spend-out of additional SSBG budget authority in each year.

The federal government provides financial support for dependent care through the Dependent-Care Tax Credit and the Social Services Block Grant (SSBG). The tax credit permits taxpayers to reduce their federal income tax liabilities by a specified percentage of employment-related expenses for care of children under age 15 and certain other dependents. The credit is granted on a sliding scale--30 percent of up to $4,800 in allowed expenses for taxpayers with adjusted gross incomes (AGI) of $10,000 or less, declining one percentage point for each additional $2,000 of AGI to 20 percent for those with incomes above $28,000. The SSBG funds a wide variety of social services, including day care for children and other dependent people.

Tightening the tax credit and expanding the SSBG--with the stipulation that the additional funds be used for dependent care for low-income families--would reduce the deficit while expanding services for those most in need. The tax credit could be more steeply graduated than it now is, declining by one percentage point for each additional $1,000 of AGI over $10,000 and phasing out completely for those with an AGI above $39,000. If half of the additional revenues were applied to the grant program, the net reduction of the deficit would be $135 million in fiscal year 1988 and $4,275 billion over the 1988-1992 period.

This option would help meet the growing need for dependent-care services for low-income families. For example, about 5 million children under age 6 lived in poverty in 1985--an increase of 1.5 million since 1979--and 56 percent lived in single-parent households. The families of these children can have difficulty obtaining high-quality child care without assistance, and